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UNCLAS SECTION 01 OF 02 BRASILIA 002500

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SENSITIVE

DEPARTMENT FOR WHA/BSC

E.O. 12958: N/A

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SUBJECT: PENSION REFORM CLEARS HURDLE IN BRAZILIAN CHAMBER OF DEPUTIES

REF: BRASILIA 2407

1. (U) Summary: Early on 6 August the Chamber of Deputies (the lower house of Brazil's congress) passed a constitutional amendment bill that, if it ultimately becomes law, would radically change Brazil's public sector pension system. Key features of the measure are analyzed in reftel and para 4 below. Passage of the proposal has become a test of the Lula government's will and capacity to make fundamental reforms in Brazil. Possible "destaques" ("observations") on the text -- some of them controversial -- will be debated later in the plenary, but congressional sources believe the government has the votes to defeat these challenges, despite continuing protests by public sector employees. The final text will be put to an obligatory second vote in the plenary later this month, and if again supported, will move to the Brazilian Senate. End Summary

The Process

2. (U) To carry the measure, the government needed a three-fifths majority (308 votes). The amendment bill passed by a 358-126 vote margin, with nine abstentions. About 100 "destaques" ("observations" or "highlights") to the text were proposed throughout August 5, but only 14 reportedly survived for debate later (time not yet set) in the plenary. These "destaques" deal with controversial aspects of the amendment, including contributions to the retirement system by inactive/retired employees, and modifications to contribution requirements for individuals with multiple income sources. While these will be hotly debated, one congressional source told poloffs the government coalition has sufficient votes to defeat these challenges. Large-scale demonstrations occurred around the congress in Brasilia throughout the day on 6 August, as different interest groups sought to put pressure on legislators and the GOB.

3. (U) Constitutional amendments require two plenary votes, separated in time by at least five plenary sessions, but the second vote normally serves to formalize the text (plus agreed-to "highlights") approved in the first round of voting. A second and final vote could occur as early as next week, or as late as the first week in September.

The Substance

4. (U) Reftel provides details of the bill voted this week. Substantively, the bill's latest version incorporated GOB concessions arising from negotiations with government allies. The key change was GOB acceptance of a sub-ceiling for state judiciary salaries (85.5 percent of federal salaries), somewhat higher than what was originally offered (75 percent). The compromise came after Lula himself publicly dug in his heels against the 90-plus percent demanded by the state judges. Other eleventh-hour adjustments were: (1) more generous guidelines for survivor benefits; (2) a higher floor for taxation of pensions, now to begin at 1,200 rather than the 1,058 reals per month that had been proposed; (3) an 11 percent pay premium for the 100,000-plus public sector workers who already qualify for retirement under existing age and time of service requirements (as an incentive for them not to retire before they satisfy the bill's new minimum limits).

5. (SBU) Comment: Further pitfalls remain. One controversial point for debate, and a possible judicial challenge later, will be the provision to begin taxing pensions. Former President Cardoso's effort along those lines were ruled unconstitutional by the Supreme Court. Pension reform is a vital necessity for Brazil's long-term economic health, since the country cannot sustain the huge fiscal deficits due in considerable measure to paying highly generous benefits to retired civil servants. In its eight years in office, the Cardoso Administration was unable to secure significant public sector pension change. The reform measure passed Aug. 6 goes to the heart of long-standing entitlements viewed as sacred by employees in Brazil's huge public sector. If a meaningful bill survives the political

and judicial challenges that still loom, the Lula government will deserve major credit for demonstrating both the political courage to take on this critical issue and the skill to see it through. The jury is still out on that latter quality. End comment.

Hrinak